KOFA HIGH SCHOOL SOCIAL SCIENCES DEPARTMENT

ECONOMICS - PERSONAL FINANCE WORKSHOPS

 # 1 - SETTING FINANCIAL PRIORITIES

Vocabulary Keys : Words that are in ***bold*** *= are terms that appear in one of the chapters , Words that are underlined = supplemental vocabulary . Ask questions about these words if you are not familiar with them !*

HOW TO SET PRIORITIES

1. Narrow your objectives

You probably won't be able to achieve every ***financial*** *goal you've ever dreamed of. So identify your goals clearly and decide which are most important, and why they matter to you. By concentrating your efforts, you have a better chance of achieving what matters most.*

2. Focus first on the goals that matter

To accomplish primary goals, you will often need to put equally desirable but less important ones on a back burner.

3. Be prepared for conflicts

Even worthy goals often conflict with one another. When faced with such a conflict, you can sometimes choose by applying criteria like: Will one of the conflicting goals benefit more people than the other? Which goal will cause the greater harm if it is deferred?

4. Put time on your side

The most important ally you have in reaching your goals is time. Money stashed in savings accounts or invested in **stocks and bonds** *grows and compounds. The more time you have, the more chance you have of success. Your age is a big factor -- younger people (who have more time to build their nest egg) can act differently than older ones.*

5. Choose carefully

In drawing up your list of goals, you should look for things that will help you feel financially secure, happy or fulfilled. Some of the items that wind up on such lists include building an emergency fund, getting out of debt, and paying the kids' tuition. Once you have your list together, you need to rank the items in order of importance

6. Include family members

If you have a spouse or significant other, make sure he or she is part of the goal-setting process. Children, too, should have some say in goals that affect them

7. Start now

The longer you wait to identify and begin working toward your goals, the more difficulty you'll have reaching them.

8. Sweat the big stuff

Once you have prioritized your list of goals, keep your spending on course. Whenever you make a large payment for anything ask yourself: "Is this taking me nearer to my primary goals -- or leading me further away from them?" If a big expense doesn't get you closer to your goals, try to defer or reduce it.

9. Don't sweat the small stuff

Although this lesson encourages you to focus on big-ticket, long-range plans, most of life is lived in the here-and-now and most of what you spend will continue to be for daily expenses -- including many that are simply for fun. That's okay -- so long as your long-range needs are also provided for.

10. Be prepared for change

Your needs and desires invariably change as you age, so you should probably reexamine your priorities at least every five years.

IDENTIFYING GOALS

You probably won't achieve every financial goal. But you can go farther than you think.

What are your top three financial objectives?

Most people, when asked that question, answer with general goals, such as achieving financial security.

The fact is, many of us have never thought much about which financial objectives really matter most. Instead, we muddle through our financial lives, spending to meet the day-to-day expenses that always clamor for attention.

There's nothing terribly wrong with that approach -- except that it risks leaving the most important objectives unfulfilled.

That's what this lesson is all about: helping you identify the financial goals that matter most to you so that you can make sure they happen.

That's not as easy as it sounds, since financial goals continually collide with one another. Paying for a child's braces may rob money that would otherwise go into his college fund, for example. And saving effectively for your kids' college can wipe out any hope of putting aside adequate money for your own retirement.

That's why to get what you want most you must 1) decide which goals will take priority and 2) work toward the lesser goals only after the really important ones are well provided for.

Fortunately, you have at least one ally in meeting your long-range goals: time. That's an advantage because of the power of compounding (***Rule of 70*** *) -- the fact that even a small amount of money can earn interest, and that each year that interest gets applied to a growing sum of money.*

Suppose, for example, you put aside only the cost of a single candy bar -- about 65 cents -- each day. Invested in a tax-deferred account paying 5 percent a year compounded monthly, that string of savings would grow to $3,073 in just 10 years and to $16,470 in 30 years.

To put the power of compounding on your side, you have to start early. Suppose there are two siblings who both invest in ***Individual Retirement Accounts (IRA s)*** *earning 8 percent a year.*

The sister starts at age 20, and for the next 10 years she stuffs $3,000 a year into her IRA. At age 30, though, she stops and never adds another penny.

Her brother waits until age 30 to get started, but then dutifully salts away $3,000 a year for the rest of his life. Which sibling do you think will be better off?

In this case, the early bird will always be ahead. The sister reaches age 65 with over $642,000, while her brother will have a little under $518,000 -- about 20 percent less.

Of course, it's far better, to start early AND keep it up. If both siblings started saving $3,000 a year in an IRA at 20, and kept it up until retirement, each would end up with nearly $1.2 million.

The point is that to put time on your side, you need to decide early which of the many possible financial goals are really worth pursuing -- and start working toward them.

To get started, make a list of all the things that you'd need to feel secure, happy or fulfilled. These can range from the weighty (getting out of debt) to the luxurious (a Lamborghini). You don't need to prioritize them yet.

But you should try to get down all of the money-related things that will really get your motor started. And if you have a spouse or significant other, it's a good idea to do this exercise together -- assuming you think your relationship can survive it! Here are some of the less frivolous items that you may want to include among the possibilities:

- *Accumulating enough savings to handle an emergency*
- *Buying a house large enough to accommodate you comfortably*
- *Getting out of debt -- and staying out*
- *Ensuring that your parents are comfortable and well taken care of in their old age*
- *Paying for your children's college education*
- *Amassing enough wealth to retire comfortably*

Once you have your list in hand, push on to the next section where you'll determine which of these goals are most important to you.

RESOLVING CONFLICTS

Retirement or the kids' tuition? Here are guidelines for making some tough choices.

After you've clarified your priorities, what do you do with your new insight?

Each time you spend more than pocket change on a purchase that doesn't help you attain one of your chief goals, ask yourself whether the outlay is really necessary.

For example, let's say your highest priority is achieving financial independence. And let's say you've saved $4,000 to take the family on a vacation. If you take the trip, you'll be an additional $4,000 from kissing the time clock good-bye (further, actually, since $4,000 in savings would grow to nearly $20,000 invested for 20 years at a tax-deferred 8 percent)

Of course, if your family has been expecting the trip for months, you'd be unfair to tell them that it's off. Instead, from the beginning you should have earmarked the cash for your investment portfolio and either planned a low-ticket vacation or worked a deal with family members to take the trip later.

Okay, you say, but that choice isn't terribly difficult. You're more concerned about tougher decisions -- choosing, for instance, among such priorities as health care, education, and savings. All are important. How do you resolve conflicts among them? No single approach will work for everyone -- but here are some guidelines that may help.

Is someone's health involved? If you believe that the ultimate purpose of money is to make life better, then you might decide that saving cash at the cost of your well being -- or of a relative's -- is a poor choice. For most people, someone's illness is the rainy day for which they've been saving.

How many people will be affected by my choice? Will one of your goals make your own life better while another will give equivalent help to two of your children? You could decide that when more people derive roughly equal benefit from a goal, its priority rises.

*If two goals offer similar rewards, which causes the least harm? This method of selection is typically a last resort, but it can be useful when no other analysis helps you decide among options. Most people, for example, have to decide between the kids' tuition and their own retirement savings. Well, if you know that you won't be able to live adequately on the money you expect from your pension and **Social Security**, then retirement savings should be paramount. As for the child in college, he can take out a tuition loan.*

You can't put every nickel toward top priorities, of course -- nor should you. Instead, you need to set aside part of your income for current pleasures, so long as you have enough cash left over to put toward your long-range goals.

Also, remember that as the years go by, your priorities will change. You'll need to reexamine and rank your needs regularly throughout life in order to use your money most effectively.

When you can save a dollar, though, you need to decide why you're putting it away. In addition, if you acquire the habit of quickly rating the urgency of every big purchase against the primary financial goals you've set for yourself, you'll eventually find that your spending is under control.

MAKING PLANS

Now that you've identified the right goals, here are some game plans that will achieve them.

Here are examples of plans you might draw up to meet three of the most common objectives: getting out of debt, paying for college, or financing a retirement:

Getting out of debt :

If you struggle to meet credit-card payments every month, then face it: You probably need to shed or consolidate some of that debt.

For example, suppose you owe $3,000 in outstanding credit-card debt at a 16 percent interest rate and a $10,000 car loan at 9 percent. To pay off both these obligations in a year, you'd need to pony up $1,147 a month.

But if you are a homeowner with equity in your property, you could borrow $13,000 on a home-equity loan at the same 9 percent and retire those other bills. Then your cost to pay off the home-equity loan in a year would be slightly lower -- $1,137 a month -- because you're no longer paying high credit-card rates of interest.

Moreover, because you can deduct the interest on most home-equity loans, you'd reduce your taxable income by $642 that year -- a $212 saving for someone in the 33 percent federal tax bracket. In effect, the government would help you pay off your nagging expenses.

Of course, this kind of strategy works only if you stop putting new charges on your credit cards at the same time.

Paying for college :

Tuition, room and board at a private college can cost upward of $30,000 a year, and that bill is projected to reach about $80,000 in the next twenty years .

Your children may qualify for financial aid either in the form of a scholarship or a loan, and many students work their way through college.

*But if you want to spare your kids the burden of graduating in debt, there are a couple of good savings vehicles available to you. Most states now offer so-called 529 Plans -- contributions go into in pre-selected **mutual funds**, grow tax-free each year, and withdrawals to pay tuition are also tax free.*

You could also open a Coverdell Education Savings Account (previously called an Education IRA) that lets you put $2,000 a year, after taxes, into a bank account or other investments; earnings on that type of account are totally tax-free, provided the money is used for tuition when it's withdrawn. It's amazing how far these plans will get you. For example, if you started putting $2,000 a year today into a Coverdell account earning 8 percent, after 18 years you'd have more than $80,000.

Financing retirement :

A popular rule of thumb says that retirees need only 70 percent of their pre-retirement income to maintain their lifestyle, since they no longer have to pay for such costs as commuting or for work clothes.

However, other costs go up in retirement, such as utility bills (if you're home all day), the price of hobbies and travel -- and, of course, the cost of health care. In fact, some retirees find they need as much income in retirement as they spent while working.

Unfortunately, traditional pensions (for public sector workers) pay only a fraction of your salary, and Social Security won't make up the difference. In addition, the younger you are, the less certain you can be about how much money you'll receive at age 65 from any of the retirement plans you have today. Why? Because Social Security benefits may be revised, and employers are free at any time to change their pension-plan formulas (employers can't do so retroactively -- every retirement dollar that you've already qualified for is yours to keep).

*Moreover, the **bear market** of the past few years has underscored the point that stocks can be extremely volatile in the short term, even if they remain among the most consistent performers over long periods. Thus, the stock portion of any retirement **portfolio** needs to take into account the possibility of sharp downturns.*

*To make your retirement finances secure, you need to contribute to as many different plans as possible. If you have a **401(k), or 403(b)**, put in as much money as you can. Most employers will match your contributions, giving you money for retirement that you won't get any other way. If you have no retirement plan at work, contribute to an IRA. Note that contributions to all of these plans are tax-deferred, so that you, Uncle Sam, and your boss together could be adding to your retirement stash.*

Then to insure against possible new retirement-plan rules mandated by Congress, you need to have your own taxable savings plan as well -- ideally invested in stocks, bonds, or mutual funds which generally return more than bank accounts. Best of all, as your investing account grows, it can help you finance other goals as well.